IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

A. B. PITTMAN, Trustee, National Cottonseed Products Corporation, Bankrupt,
Petitioner,

vs.

UNION PLANTERS NATIONAL BANK AND TRUST COMPANY, ET AL.,
Respondents.

No.....

BRIEF AND ARGUMENT IN SUPPORT OF PETITION

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Jurisdiction.

The jurisdiction of this Honorable Court is sought under Section 240 of the Judicial Code as amended, U.S.C.A., Title 28, Sec. 347, and under Rule 38 of the rules promulgated by this Honorable Court.

The decision of the Circuit Court of Appeals in this case is reported as Pittman, Trustee, v. Union Planters National Bank and Trust Company, et al., 118 Fed. (2d) 211.

Question Presented For Review.

Were the so-called field warehouse receipts on cottonseed pledged to respondents adequate to create a lien valid under State law as against the Trustee in Bankruptcy?

The solution of the foregoing question depends upon the facts which were reported by the Master and are the basis of his conclusion, that of the District Judge, and that of the United States Circuit Court of Appeals, Sixth Circuit:

> "The National Corporation was organized and operated for the purpose of buying and crushing cottonseed and selling the products resulting from that operation, such as oil, meal, cake, hulls and linters." (Vol. 2, p. 362.)

Several years before this petition was filed the bankrupt, being without funds, arranged to carry on business and incur liabilities through the medium of a system of field warehousing. On July 9, 1931, it entered into an agreement with the Nashville Warehouse and Elevator Corporation, which company had no storage facilities in any of the

places where the bankrupt did business, the sole object and purpose of which was to issue warehouse receipts which could be used to obtain credit (Vol. 2, p. 341). The agreement provided:

> "This confirms our understanding wherein you agreed to warehouse for us for the season of 1931-1932 our cottonseed, cake and meal at the following locations:
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> | | |
> |---|---|
> | Morrilton, Arkansas | Cairo, Illinois |
> | Little Rock, Arkansas | Dyersburg, Tennessee |
> | Pine Bluff, Arkansas | Jackson, Tennessee |
>
> 3 of our mills in Memphis, known as the Dixie, Valley and Bellevue, making a total of 9 mills.
>
> We are to lease you our storage facilities at those points under a lease to be approved by Mr. Berry, your counsel. We are to pay the expenses of the qualification of your company to do business in Arkansas and Illinois. You are to furnish the necessary employes for this purpose on as economical basis as is consistent with good business and safe warehousing, and all of those expenses are to be paid by our company monthly, and we are to pay you as your net compensation in the matter, the sum of $6,000 over and above all of the necessary expenses of said warehousing as outlined above.
>
> You are to issue warehouse receipts for cottonseed, cake and meal stored with you in the above described warehouses in a form to be approved by Mr. Berry, and in addition we agree to give you an acceptable guarantee protecting you from all loss, cost or damage in connection with the storage of cottonseed, cake and meal, excepting only loss, cost or damage resulting from your own wilful misconduct." (Exh. 325.)

Pursuant to that agreement written leases were executed on the bankrupt's premises and a form of warehouse receipt was adopted. The warehouse company appointed one

of the bankrupt's employees at each mill as custodian and required of him a fidelity bond (Vol. 2, p. 341).

They had some signs printed which the printer testified were the most difficult of any kind of type to read, and that he had never printed any such signs for advertising, etc. (Vol. 2, p. 356.)

In the fall of 1934 the warehouse company required of the bankrupt a written agreement expressly relieving the warehouse company of every duty of a warehouseman, and agreeing,—"to protect and save harmless Nashville against any loss, cost or damage arising from the storage of said cottonseed not arising out of the wilful neglect or default of Nashville." The agreement imposed upon the bankrupt the duty to inspect the seed, handle the seed, check the seed, defend all suits which might be brought against the warehouse company because it had issued those receipts, and again expressly imposed upon the bankrupt the duty to pay every expense of every kind and character incurred in connection with this field warehousing system (Vol. 2, p. 345; Exh. 33).

The foregoing represents the field warehousing system as it appeared on paper and in theory. The Master found and reported the following facts:

> "The written leases were not registered. A yearly rental of Ten ($10.00) Dollars and ten (10c) cents per ton for all seed warehoused was provided, but no rental was ever paid." (Vol. 2 ,p. 342.)*
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> "The leases further provided that where only a portion of a building was leased then the space:
>
> 'Shall, at the sole expense of the lessor, be separated by walls, wire fences or such barriers named

*The Master consistently cited the record supporting his findings. To conserve space, we will omit his record citations when quoting.

by the lessee as effectively and conclusively set aside, indicate and designate that part of the building covered by this lease.'

Such space was never separated by the walls, fences or barriers, and this is particularly true of the Pine Bluff mill." (Vol. 2, pps. 342-343.)

"* * * no walls, barriers or partitions were ever erected and the National and its employees continued to use the premises exactly as before the warehousing arrangement was made." (Vol. 2, p. 350.)

"The duty required of each mill warehouseman was to make a written report daily of the quantities of cottonseed and products received, disposed of and remaining on hand at each mill, the figures to be ascertained from the records and reports of the National." (Vol. 2, p. 350.)

The head warehouseman stationed at the bankrupt's main office,—"complied and kept a record of the quantity of cottonseed and products on hand at each mill from the daily reports furnished him by the mill warehouseman, issued and cancelled warehouse receipts and kept a record thereof." (Vol. 2, p. 350.)

"The mill warehousemen devoted their services to the business of the National except for the time necessary to perform the duties required of them on behalf of the Warehouse Company, which was usually about thirty minutes a day; generally the mill warehousemen were clerical employees of the National with duties confined to the office.

"The salaries of the central control warehouseman and the mill warehouseman, premiums on the warehousemen's bonds, the cost of printing warehouse receipts and all other forms, the expense of qualifying the Warehouse Company in various States where the National operated and every other expense that accrued in warehousing the seed and products was paid by the National; a monthly bill was rendered by the

Warehouse Company for salaries and expenses and it was reimbursed by the National. It was conceded that the National reimbursed the Warehouse Company for every expense it incurred, and paid the Warehouse Company a fixed fee of $666.66 per mill for the season. The total of all expenses amounted to the net sum of $19,304.73 for the season of 1934-35.

"The National bought, paid for and acquired the title to all cottonseed which came into its possession and stored in the seed-houses.

"Unless and until warehouse receipts were issued the National had the right to crush and use the entire seed inventory, unaffected by any provision of the warehousing agreement.

"Prior to the issuance of warehouse receipts the cottonseed was stored in the various seed-houses. After receipts were issued there was no change of actual possession. Operations continued exactly as before and the seed was handled exclusively by National's employees.

"The Warehouse Company had no employees stationed at the plants of the National who took any part in the handling of the seed from the time the seed were received and placed in the seed-houses and the products were shipped out.

"The National's mill superintended and the employees under him went in and out of the buildings and seed-houses during the crushing season of 1934-35 discharging their duties in the ordinary way. It was necessary for the mill superintendent and the employees to have free and uninterrupted access to the seed-houses, the meal houses, the cake storage space, the linter houses, platforms and the hull houses in order to carry on the crushing of the seed and marketing of the products.

"About ninety employees of the National worked daily at the Dixie plant and a proportionate number at the other plants, according to the size of the plant.

"The seed was stored in bulk in the seed-houses and no attempt was made to segregate the seed under warehouse receipt from the bulk. Neither seed nor products were tagged, labeled or marked.

"When cottonseed was withdrawn from the cottonseed houses for crushing purposes it was removed by mechanical conveyors operated exclusively by employees of the National feeding the seed into the conveyor by hand. The entire operation was performed under the supervision of the plant superintendent.

"When the seed was crushed the oil would run into settling tanks where it would remain for several days and from there it would be pumped into storage tanks.

"The cake would go into the grinding room adjoining the crushing-room where it would be broken into nuts or ground into meal and conveyed by machinery into bins which were a part of the main mill building.

"The linters would go directly to a linter-house, shed or platform and remain there until sold and shipped out; the hulls would go to the hull-houses.

"The cottonseed-houses were never locked and no means were employed for excluding the National and its employees from them.

"When the mills were not in operation some of the mill buildings, not the cottonseed-houses, were locked and the plant superintendent and nightwatchman only carried the keys.

"When the mills were closed down and at nights when not running and on Sundays a nightwatchman in the employ of the National was on the premises and was in charge of the plant as watchman.

"Business was freely transacted whenever necessary in the mill buildings, the seed-houses, the hull-houses by employees of the National and its customers.

"Neither the mill manager nor the plant superintendent was required to obtain specific permission from the Warehouse Company to withdraw seed for crushing or products for sale and shipment.

"At no time prior to January 23, 1935, did any mill warehouseman interfere in any way with the operation of the plant, with the handling or crushing of the seed or the handling and sale of products.

"Throughout the season 1934-35 the National crushed its seed and sold its products in the ordinary course of business, collected from its customers and deposited the proceeds of sale in its general bank account.

"To ascertain the quantity of seed withdrawn from the seed-house by conveyor for crushing in the mill, a seed-house by conveyor for crushing in the mill, a theoretical figure is used; the theoretical figure or factor determined the grade and the indicated yield of products per average ton of cottonseed, and mills usually employ such a factor as to cause the withdrawal of a less number of cottonseed than is indicated by the theoretical factor; the actual quantity on hand may be adjusted from time to time as the quality of the seed varies or when the entire quantity of seed are crushed. When the seed was sold and finally disposed of in this cause there was no shortage of seed on hand compared with outstanding warehouse receipts."

"The mill managers and mill warehousemen kept no record of outstanding warehouse receipts against the seed and products in their respective mills and if this information was desired it would have been necessary to ascertain it from the central control warehouseman in Memphis. The quantities were shifting from time to time." (Vol. 2, pps. 350-354.)

"Warehouse receipts were issued from time to time for 100 tons or other convenient quantity of cottonseed and each receipt specifically designated the location of the seed or products described therein at a particular mill.

"During the operating season of 1934-35 cottonseed was crushed or shipped at times when seed on hand at the respective mills was less than the quantity called for by outstanding warehouse receipts designating seed at the respective mills. The Trustee audited the

records of the Warehouse Company and submitted a comparative statement of cottonseed on hand at various mills and warehouse receipts issued, which statement showed an over-issuance of warehouse receipts on the dates disclosed. On the closing date of the audit there was, however, cottonseed on hand at each mill in excess of outstanding warehouse receipts."* (Vol. 2, pps. 354-355.)

Although the warehouse receipts (conforming on their face to the requirements of the Negotiable Warehouse Receipts Act) designated the quantity called for by the receipt, the town and state in which the seed or products was located, and the warehouse number—the banks, the bankrupt and the warehouseman utterly disregarded all this and after this litigation started, claimed that they had an agreement whereby warehouse receipts could be outstanding and held as collateral calling for seed or products at a specified mill, when in fact there were no seed or products there, provided there was excess seed or products at some other mill in some other town, or in some other state. The Master finds and reports that there was a general agreement and understanding to that effect (Vol. 2, pps. 355 & 521). "At times warehouse receipts for cottonseed at a specified mill were issued when there was no seed at that mill. It was said to be a general arrangement and understanding * * *." (Vol. 2, p. 356.)

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*The Master by supplemental report corrected the last sentence in the second paragraph above quoted and the last sentence in the fifth paragraph above quoted, by showing that on the closing date, and at the time the seed was shipped out, there was an over-issuance of receipts at some of the mills calling for 1139 tons of seed, and an under-issuance at other mills of 431 tons of seed, leaving a net over-issuance of 708 tons (Vol. 2, pp. 519-520).

Loans would only be made to the bankrupt upon satisfactory evidence that firm contracts had been made for the sale of the oil to be recovered from its cottonseed inventory (Vol. 2, p. 363).

> "The financial statements and monthly balance sheets showed the seed and products inventory among current assets, but did not show that such property was hypothecated; the statements were furnished the Banks monthly and the Trustee claims that the Banks ratified and approved the National's action in showing such assets as free and unpledged.
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> "Each oil purchaser testified that they entered into their contracts knowing that the National were large buyers of seed and assumed that it was manufacturing the seed and relied upon that knowledge and had no knowledge that the seed inventory had been pledged." (Vol. 2, p. 477.)
>
> "That the Chemical Bank from and after December 11, 1934, went into the arrangement with full knowledge that the oil had been sold for future delivery; * * *." (Vol. 2, p. 477.)

The exhibits prepared by the Trustee's auditors from the records of the warehouse company (Exhs. 207-215) showed that warehouse receipts were issued and allowed to remain outstanding without any regard to quantities on hand. The Master found and reported:

> "* * * It was his (the Trustee's) further insistence that an audit (Exhs. 207-215) disclosed that the Warehouse Company did not attempt to make quantities on hand correspond to outstanding warehouse receipts and that the head warehouseman was forced to admit it, and I so find." (Vol. 2, p. 346.)
>
> "No signs indicating the warehousing of cottonseed products were printed, but the sign (Exh. 18) covering cottonseed was in some instances posted where products were stored in the rented spaces and in several

instances posted on linter, hull and meal houses. No effort was made to give any kind of notice that products were being warehoused except as stated by the use of a cottonseed sign. After the filing of the proceedings herein a rush order was placed for products signs and they were posted in conspicuous places on product storage spaces, oil tanks, meal, hull and linter houses and platforms.

"It was understood between the National and the Warehouse Company that products at any mill could be shipped though the amount on hand was smaller than the outstanding warehouse receipts, provided that there were excess quantities at other mills; that for this purpose warehouse receipts calling for cottonseed cake could be used to cover excess quantities of meal at that mill; that meal and cake were interchangeable products, that the grade of linters were interchangeable regardless of the grade on hand." (Vol. 2, pps. 361-362.)

The loan agreement pursuant to which the claimant banks took and held the warehouse receipts in question contained the following vitiating provision:

"It is understood however by the parties hereto that the said cottonseed Corporation has the right to consume or use such of said items as by their nature are necessarily consumable for the purpose of operating said mills, and has the right to sell and ship out such of said items as must be sold in the ordinary and usual operation of said business, such use and sale being necessary to secure the cash funds with which to purchase more cottonseed, products and supplies thus enabling them to make the continuing turnovers necessary to the profitable operation of a cottonseed oil mill business. (Exh. 391, p. 4.)" (Vol. 2, p. 363.)

The Master concluded his finding of Evidentiary Facts as follows:

> "It is contended by the Trustee that the credit extension agreement with the Banks (Exh. 391), the agreement on the part of the Chemical Bank & Trust Company (Exh. 16), the issuance of the trust receipts (Exhs. 339, 340, 341), and the testimony of the President of the Chemical Bank, all evidence the fact that the National should consume by use and exhaust by sale all of the pledged property and repay the Banks the money borrowed, and I find that these documents show the knowledge and intent of the parties." (Vol. 2, p. 364.)

ASSIGNMENT OF ERRORS.

The United States Circuit Court of Appeals for the Sixth Circuit erred in failing and refusing to reverse the decree of the District Court and in holding that the field warehouse receipts on cottonseed were valid and adequate to vest a lien in the respondent banks as pledgees thereof. This was error because:

(a) Neither the respondent banks nor the field warehouseman ever had the actual, open and exclusive possession of the cottonseed.

(b) The warehousing arrangement did not contemplate any actual change of possession, except on paper and in theory, and there was no change of possession after the warehousing arrangement was made, nor after the receipts were issued. Operations continued exactly as before and the seed was handled exclusively by the Bankrupt's employees.

(c) The respondent banks and the Bankrupt agreed in writing that the Bankrupt should have the right to con-

sume and use the cottonseed and to sell and ship out the products in the ordinary and usual operation of the business.

(d) The respondent banks, the warehouseman and the Bankrupt entered into an agreement whereby is was understood and agreed that the Bankrupt could consume and use any or all of the cottonseed stored at any one or more of its mills, although covered by specific receipts calling for seed at that location, without a surrender of the receipt, provided, there were excess seed at some other mill in some other location. This was in direct violation of the Tennessee Uniform Warehouse Receipts Act; and it was error for the Court to hold that the receipts could be so altered by oral agreement between the respondent banks, the warehouseman and the Bankrupt, as against creditors and the Trustee in Bankruptcy. Such agreement falsified every warehouse receipt and contravened the terms of the Warehouse Receipts Act.

POINTS OF LAW.

I.

There can be a valid arrangement whereby "field warehousing" can be conducted and pursuant to which negotiable receipts can be issued, affording valid security to the holder of the receipts.

Union Trust Co. v. Wilson, 198 U. S. 530, 25 S. Ct. 766, 49 L. Ed. 1154;
Bank of Rome v. Hazelton, 83 Tenn. 216.

II.

The fundamental requisite to any form of warehousing as a basis for the issuance of warehouse receipts, be it field

warehousing or the ordinary and customary manner of warehousing, is that the warehouseman must take and maintain the sole, open, actual and exclusive possession of the property. The warehousing arrangement is essentially a bailment which cannot exist without the actual transfer of possession.

The basic and fundamental principles underlying this rule are that (1) a debtor cannot create an unrecorded lien upon his property in favor of one or more creditors and retain possession with outward show of ownership, and (2) retention of possession with express or implied right to consume in use and exhaust by sale is inconsistent with and repugnant to any form of lien.

See cases cited under next proposition.

III.

In order that a warehouse receipt, negotiable in form, issued pursuant to a field warehousing arrangement, may attach to the property, or vest any right to the property in the holder, the warehouseman must take and maintain the actual, open and exclusive possession and control of the property.

Union Trust Co. v. Wilson, 198 U. S. 530, 25 S. Ct. 766, 49 L. Ed. 1154;
Bank of Rome v. Hazelton, 83 Tenn. 216;
Security Warehousing Co. v. Hand, 206 U. S. 45, 51 L. Ed. 1117;
Security Warehousing Co. v. Hand (C.C.A. 7th), 143 Fed. 32;
Love v. Export Storage Co. (C.C.A. 6th), 143 Fed. 1;
American Can Co. v. Erie Preserving Co. (D.C.), 171 Fed. 540 (C.C.A. 7th), 183 Fed. 96;
67 C. J. 465, Sec. 36;

Maryland Casualty Co. v. Washington L. & B. Co. (Ga.), 145 S. E. 761, 61 A.L.R. 323;
McGaffey Canning Co. v. Bank of America, 294 Pac. 45, 109 Cal. Apps. 415;
Negotiable Warehouse Receipts Act, Williams Tenn. Code, Sec. 7587;
Sec. 50, Uniform Warehouse Receipts Act (Adopted in Illinois, Arkansas and Texas);
Vol. 3, Uniform Laws Annotated, p. 83.

IV.

There is no deposit with the warehouseman sufficient to pass any right, title or interest in the property by virtue of a receipt issued thereon, if the goods are stored on the premises of the debtor and the debtor has access to, and partial control over or use of the property. And this is true, even though the warehouseman takes a lease on the premises, puts up signs, employs a nominal custodian, contracts for the exclusive possession of the premises, walls off the premises and puts on locks. Access to, partial control over and use of the property by the debtor, substantially as before, vitiates all forms which the parties may go through.

Security Warehousing Co. v. Hand (C.C.A. 7th). 143 Fed. 32; 206 U. S. 415;
American Can Co. v. Erie Preserving Co. (D.C.), 171 Fed. 540 (C.C.A. 7th), 183 Fed. 96;
Love v. Export Storage Co. (C.C.A. 6th), 143 Fed. 1;
In re: Rogers (C.C.A. 7th), 125 Fed. 169;
Re: Spanish-American Cork Products Co. (C.C.A. 4th), 2 Fed. (2d) 203;
Fourth St. Nat'l Bank v. Milbourne Mill Cos., Trustee (C.C.A. 3rd), 172 Fed. 177;
McGaffey Canning Co. v. Bank of America, 294 Pac. 45, 109 Cal. App. 415;
67 C. J. 486 (Warehousemen Sec. 69).

V.

Since actual, open and exclusive possession and control by the warehouseman, as distinguished from merely formal or colorable control, is absolutely essential to pass any right or interest in the property to the holder of a warehouse receipt, it becomes necessary to determine in this case whether the formalities gone through by the warehouseman have resulted in actual and exclusive possession.

(a) Taking a lease providing for exclusive possession by the warehouseman, lessee, is wholly insufficient to constitute exclusive possession if the debtor's use of the premises and access to the goods stored therein, "continues substantially as before."

Security Warehousing Co. v. Hand (C.C.A. 7th), 143 Fed. 32; 206 U. S. 415;
Williams v. First Nat'l. Bank, 150 Tenn. 15;
In re: Rogers (C.C.A. 7th) 125 Fed. 169;
American Can Co. v. Erie Preserving Co. (D.C.), 171 Fed. 540 (C.C.A. 7th), 183 Fed. 96;
Re: Spanish-American Cork Products Co. (C.C.A. 4th), 2 Fed. (2d) 203;
McCaffey Canning Co. v. Bank of America, 294 Pas. 45, 109 Cal. App. 415.

(b) Placing a nominal representative or custodian on the premises is insufficient if the debtor be permitted access to and use of the goods stored on the premises, substantially as before.

Security Warehousing Co. v. Hand (C.C.A. 7th), 143 Fed. 32;
Love v. Export Storage Co. (C.C.A. 6th), 143 Fed. 1;
American Can Co. v. Erie Preserving Co. (D.C.), 171 Fed. 540 (C.C.A. 7th), 183 Fed. 96;
Re: Spanish-American Cork Products Co. (C.C.A. 4th), 2 Fed. (2d) 203;
Re: Coats, Bennett & Reidenbach (C.C.A. 2nd), 12 Fed. (2d) 497.

(c) Putting up signs is wholly insufficient if the debtor continue to use its raw material and stock in trade substantially the same after the issuing of the receipts as before. The right of the receipt holder to any interest in the property depends upon actual, open and exclusive possession by the warehouseman and nothing can substitute for it. There is no transfer of possession by merely putting up signs which say that the exclusive possession is in the warehouseman.

Hyman v. Semmes (C.C.A. 6th), 26 Fed. (2d) 10;
Re: Coats, Bennett & Reidenbach (C.C.A. 2nd), 12 Fed. (2d) 497;
Re: Spanish-American Cork Products Co. (C.C.A. 4th), 2 Fed. (2d) 203;
Security Warehousing Co. v. Hand (C.C.A. 7th), 143 Fed. 32;
Ommen v. Talcott (C.C.A. 2nd), 188 Fed. 401.

(d) A combination of all the formalities enumerated in (a), (b) and (c) is wholly ineffectual to constitute valid warehousing. There can be no substitute for the actual, open and exclusive possession by the warehouseman.

(See cases cited under (a), (b) and (c).

VI.

Signs inconspicuously placed and difficult to read fall within the following characterization by the Circuit Court of Appeals for the 2nd Circuit:

> "This is one of the innumerable schemes by which merchants have attempted to create liens on their goods which shall be unknown to their creditors and shall not affect their credit, but which shall be enforceable if bankruptcy occurs. They are all based on the idea of giving notice enough to satisfy the law and not enough to inform the creditors."
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> Ommen v. Talcott (C.C.A. 2nd), 188 Fed. 401.

VII.

The fact that a debtor agrees never to reduce the stock on hand below the quantities indicated in the warehouse receipts does not establish the requisite "actual possession and control" and does not support the warehousing arrangement. That fact does not validate the transaction and the holder of the receipts cannot prevail against a trustee in bankruptcy.

American Can Co. v. Erie Preserving Co. (D.C.), 171 Fed. 540 (C.C.A. 7th), 183 Fed. 96;

Fourth St. Nat'l Bank v. Milbourne Mills Cos., Trustee (C.C.A. 3rd), 172 Fed. 177;

Bank v. Ebbert & Co., 9 Heisk. 153.

(Note: An agreement that the manufacturer will not reduce the quantities below the quantities indicated in the receipts presupposes access to, use of and control over the goods by the manufacturer and requires him to limit his own use and control of the goods. It negatives the idea of actual and exclusive possession in the warehouseman.)

VIII.

Warehouse receipts, although negotiable in form and containing all elements prescribed by the statutes, are invalid and vest no right in the holder if, in reality, the receipts do not describe any specific property, but simply call for specified quantities out of a fluctuating whole.

Interstate Banking Co. v. Brown (C.C.A. 6th), 235 Fed. 32;

Fourth St. Nat'l Bank v. Milbourne Mill Cos., Trustee (C.C.A. 3rd), 172 Fed. 177.

IX.

Even though a blanket receipt calling for "all the goods" of a depositor at a given location might be valid, the aggre-

gate of a number of receipts cannot be used to impress a lien upon a fluctuating quantity.

Interstate Banking Co. v. Brown (C.C.A. 6th), 235 Fed. 32.

X.

The Uniform Negotiable Warehouse Receipts Act provides that the receipt shall state the location of the warehouse in which the goods are stored.

This provision and requirement is conclusive of the invalidity of warehouse receipts issued pursuant to an agreement in direct conflict therewith; as in this case, the location of the commodity, as to city, county or state, was by agreement utterly disregarded—if the quantity was on hand at any one of the ten mills, located in eight cities and four states.

Williams Tennessee Code, Sec. 7533-a;
Sec. 2, Uniform Warehouse Receipts Act (Adopted by Illinois, Arkansas and Texas);
Vol. 3, Uniform Laws Ann., p. 6.

XI.

An agreement which contemplates the uninterrupted use by the debtor of quantities of seed or products at one mill in disregard of the outstanding warehouse receipts for seed or products at that mill provided there were excess quantities at a mill in some other state, would nullify and destroy any warehousing arrangement, even if it was otherwise valid, for the following reasons:

(a) The Uniform Negotiable Warehouse Receipts Act requires that the receipt shall state the location of the warehouse in which the goods described in the receipt are stored.

(b) Such an arrangement presupposes the unqualified right to use and sell all or any part of the seed or products at any particular mill. It presupposes an agreement enabling the debtor to deal with the public on the basis of an unfettered right to crush the seed and sell the products, against both of which receipts were outstanding.

(c) It presupposes the right of the receipt holders to assert title to seed or products at Jackson, Tennessee, based upon warehouse receipts calling for seed or products at Morrilton, Arkansas. It assumes that the holder of a receipt calling for seed at Dyersburg, Tennessee, could prevail against a creditor with an attachment or execution levied on seed at Pine Bluff, Arkansas, against which no receipts had been issued.

The Master states some controlling propositions of law, as follows:

"It is conceded on the briefs that the law of Tennessee is controlling, since the warehouse receipts and trust receipts were executed and negotiated in Tennessee, and this concession seems sound. Re: Collinwood Motor Sales, 72 Fed. (2d) 137, 139. (1934, C.C.A. 6.)" (Vol. 2, p. 378.)

"This use of such instruments of title or lien meets at the threshold, the law of Tennessee, which is firmly established, that there can be no title or lien on personal property that may be consumed by use or exhausted by sale. Manufacturing Co. v. Nordeman, 118 Tenn. 384, Tennessee National Bank v. Ebbert & Co., 56 Tenn. 154, Morgan Bros. v. Dayton Coal & Iron Co., 134 Tenn. 228, General Motors Acceptance Corp. v. Greene County Union Bank, 95 S. W. (2d) 948." (Vol. 2, p. 386.)

ARGUMENT.

After finding the evidentiary facts above set forth, the Master summarized his findings and stated his conclusion as follows:

> "Upon consideration of all the evidentiary facts herein found and stated, I am unable to view them other than that the warehouse company had the necessary legal possession of the cottonseed-houses and the exclusive charge and control of the cottonseed contained therein under the decisions defining the law applicable to the relationship of the parties; and, upon the whole record, that the outstanding warehouse receipts for cottonseed are valid." (Rec. V. 2, p. 370.)

That conclusion means no more than that the Master was of the opinion that the unrecorded leases gave the warehouse company legal possession of the cottonseed houses, and that the appointment of an employee of the bankrupt at each mill as custodian gave the warehouse company the exclusive charge and control of the cottonseed.

It seems certain that both the District Court and the Circuit Court of Appeals gave undue weight to this conclusion reached by the Master. It is respectfully submitted that the conclusion is not entitled to the weight accorded it, unless it conforms to the decisions of this Honorable Court and the Supreme Court of Tennessee when applied to the "evidentiary facts found." In the Hand case the warehouse company took leases and appointed custodians and put them under bond, and did everything the warehouse company did in the case at bar. This Honorable Court held that the leases did not give the warehouse company possession of the premises and that the appointment of custodians, requiring bonds, putting up signs and other formalities gone

through, did not give them the "exclusive charge and control" of the merchandise.

We have heretofore set forth the evidence as found and reported by the Master, and we desire to repeat that neither side has filed exceptions to those Evidentiary Facts. It is settled under the Federal authorities that such findings must be accepted by the parties as true. (Fleming v. Noble, 250 Fed. 733 (C. C. A. 1st).

Those Evidentiary Facts establish to a certainty the following:

(1) Actual possession of the cottonseed and products remained in the bankrupt exactly as before the receipts were issued and the bankrupt continued in business, crushing seed and selling products exactly as before. The Master reports:

> "* * * After receipts were issued there was no change of actual possession. Operations continued exactly as before, and the seed was handled exclusively by National's employees." (Vol. 2, p. 351.)

And:

> "* * * Throughout the season 1934-1935 the National crushed its seed and sold its products in the ordinary course of business, collected from its customers and deposited the proceeds of sale in its general bank account." (Vol. 2, p. 353.)

(2) It was understood by the banks, the bankrupt and the field warehousemen that under the field warehousing arrangement the bankrupt was to be permitted to consume

by use and exhaust by sale all the pledged property. The Master reports:

> "It is contended by the Trustee that the credit extension agreement with the Banks (Exh. 391), the agreement on the part of the Chemical Bank & Trust Company (Exh. 16), the issuance of the trust receipts (Exhs. 339, 340, 341), and the testimony of the President of the Chemical Bank, all evidence the fact that the National should consume by use and exhaust by sale all of the pledged property and repay the Banks the money borrowed, and I find that these documents show the knowledge and intent of the parties." (Vol. 2, p. 364.)

It is respectfully submitted that this case cannot be distinguished from Security Warehousing Company v. Hand, 206 U. S. 415, 51, 27 Sup. Ct. 720, L. Ed. 1117. Counsel for the banks have never successfully distinguished it, the Master made no attempt to distinguish it, and neither the District Judge nor the Court of Appeals attempt to distinguish it.

The facts of that case are reported fully in the statement preceding the opinion of the Circuit Court of Appeals (143 Fed., p. 32). There a company authorized to do a warehousing business (1) took a lease on a portion of the debtor's premises, (2) appointed a custodian and placed him under bond, (3) stored the goods to be warehoused on the leased portion of the premises, (4) enclosed the leased portion of the premises with substantial slatted enclosures, and (5) placed thereon padlocks bearing the following: "Premises of Security Warehousing Company of New York, Chicago, Illinois," (6) the custodian kept the key on a ring with keys belonging to himself and the bankrupt; (7) the door was kept locked except when necessary to enter the

enclosures; (8) signs were placed on the inside of the enclosures; (9) cards stating that the goods belonged to the Security Warehousing Company were affixed to the cases of goods.

The Court held that all of the foregoing failed to constitute the requisite possession by the warehouseman because the evidence showed (1) that the bankrupt continued to use portions of the leased premises not enclosed by the partitions for its own storage purposes as it had before; (2) that goods not covered by warehouse receipts were put in and taken out of the enclosures by the employees of the knitting company; (3) that the custodian was absent from the premises a large part of the time and left the keys with an employee of the bankrupt; (4) that the bankrupt's shipping clerk filled orders from cases without or within the enclosures, as need required.

With respect to the foregoing facts, the Circuit Court of Appeals, in the course of its opinion, holding the arrangement insufficient to constitute a pledge, said:

> "Delivery of possession is the very life of a pledge. No mere agreements respecting possession can create it. The contract of pledge cannot exist outside of the fact of change of possession. The pledgor must dispossess himself openly, completely, unequivocally and 'without deceptive combinations which lead third persons into error as to real possessor of the thing.' And the pledgee must take and maintain an open, exclusive and unequivocal possession." (143 Fed., p. 41.)

And:

> "The Security Company's agent on the ground to maintain an open, unequivocal and exclusive possession was the cashier of the knitting company who had charge

of the stock and of shipping. The key to the enclosure was kept on a ring with other keys used in the business of the knitting company, and this bunch of keys was accessible to the manager of the knitting company and was left at the office of the knitting company during the cashier's absences, substantially the same conditions obtained at Racine.

"If a creditor desired to look over the property of the knitting company, what would be the probable result? The cashier or shipping clerk or manager could take the bunch of keys, unlock the warehouse, show the raw materials and broken stock outside of the slatted enclosure, point out the quantity of goods within the enclosure, explain the necessity of the enclosure to prevent pilfering of the hosiery, etc., when the warehouse was opened; and nothing would warn the creditor of the deception, and the evidence satisfies us that at least one creditor was so deceived." (143 Fed., p. 41.)

In the Supreme Court statement of the facts, it said:

"These two places were occupied by the knitting company with their goods to be sold, and the goods were placed on the premises really occupied by the knitting company, although in form leased by it to the warehousing company, and the so-called warehouse receipts were given to the knitting company by the warehousing company, acknowledging the receipt of the property at such places. There was no change of possession in fact, and scarcely any in form. These receipts were in turn pledged by the knitting company to various banks, and moneys obtained upon the security of such receipts from them. The general character of business of this form is stated in Union Trust Co. v. Wilson, 198 U. S. 530, 49 L. Ed. 1154, 25 Sup. Ct. Rep. 766, but the particular facts in this case, given in detail as findings by the referee, and adopted by the district court and circuit court of appeals, may be found in 143 Fed., supra." (51 L. Ed., p. 1118.)

It denied the receipt holder's claim to a lien; and all the formalities gone through were held to be wholly inadequate to establish the possession which the law requires. The language of the Court in denouncing such an arrangement is so forceful that we quote the following from it:

> "The general law of pledge requires possession, and it cannot exist without it. Casey v. Cavaroc, 96 U. S. 467, 24 L. Ed. 779. There was scarcely a semblance of an attempt at such change of possession from the hands of the knitting company to the hands of the warehousing company. Actual possession of the property in question was exercised by and existed with the knitting company substantially the same after the issuing of the receipts as before. It is a trifling with words to call the various transactions between the knitting company and the warehousing company a transfer of possession from the former to the latter. There was really no delivery, and no change of possession, continuous or otherwise. The alleged change was a mere pretense, a sham." (206 U. S. 421, 51 L. Ed., p. 1122.)
>
> "The only property within the enclosures was the knitting company's. The knitting company did not want storage room, but collaterals, which the security company agreed to furnish for a commission upon the amount thereof plus all expenses. The security company's only agents on the scene were the agents of the knitting company." (206 U. S. 421, 51 L. Ed., p. 1122.)
>
> "So far from the security company's maintaining an open, exclusive, unequivocal possession during the two years this arrangement was carried on, it seems to us that the security company might as well have been eliminated, and the knitting company have employed its own stockkeepers and shipping clerks as custodians for intending lenders, directly, instead of indirectly through the security company. In that view this becomes one of the cases 'in which the exclusive power of the so-called bailee' (Union Trust Co. v.

Wilson, 198 U. S. 530, 537, 49 L. Ed. 1154, 1156, 25 Sup. Ct. Rep. 766) tapers away to nothingness (Drury v. Moors, 171 Mass. 252, 50 N. E. 618; Tradesmen's Nat. Bank v. Kent Mfg. Co., 186 Pa. 556, 65 Am. St. Rep. 876, 40 Atl. 1018).

"The actual transactions in the case at bar differ radically from the facts as stated in Union Trust Co. v. Wilson, supra. The court there held that there was sufficient proof to show a change of possession, and that the transaction was valid within the law of the state of Illinois. Assuming the law of Wisconsin to be the same on the subject of possession by the pledgee of the property pledged, the facts in this case are so different from the Wilson case as to prevent that case from forming a foundation for holding there was a sufficient change of possession here to make the pledge a valid one." (206 U. S. 422, 51 L. Ed. 1122.)

Space will not permit us to quote further from authorities, but we most respectfully direct attention to the following cases, all of which condemn and strike down warehousing arrangements similar to this:

In re: Rogers (C. C. A. 7th), 125 Fed. 169;
Williams v. First Nat'l Bank, 150 Tenn. 15;
Hyman v. Semmes (C. C. A. 6th), 26 Fed. (2d) 10;
In re: Spanish-American Cork Products Co. (C. C. A. 4th), 2 Fed. (2d) 203;
McGaffey Canning Co. v. Bank of America, 294 Pac. 45, 109 Cal. Apps. 415;
American Can Co. v. Erie Preserving Co. (D. C.) 171 Fed. 540, (C. C. A. 7th) 183 Fed. 96;
Fourth Street National Bank v. Milbourne Mill Co., Trustee (C. C. A. 3rd), 172 Fed. 177;
Hamilton Ridge Lumber Sales Corp. v. Wilson (C. C. A. 4th), 25 Fed. (2d) 592.

The banks are not entitled to the proceeds of the sale of the cottonseed unless they have "liens valid under state

law" (Benedict v. Ratner, 268 U. S. 353; 69 L. Ed. 991; 45 Sup. Ct. Rep. 566 (1925).

With respect to this the Master said:

> "It is conceded on the briefs that the law of Tennessee is controlling, since the warehouse receipts and trust receipts were executed and negotiated in Tennessee, and this concession seems sound. (Re: Collinwood Motor Sales, 72 Fed. (2nd) 137, 139 (1934, C. C. A. 6)." (Vol. 2, p. 378.)

Tennessee has always inexorably required an absolute, open and notorious change of possession to support a pledge of personal property, and has never permitted the use of leases, signs, contracts and agreements to be used as a substitute for change of possession (Williams v. First National Bank, 150 Tenn. 15, 261 S. W. 973).

And the Supreme Court of Tennessee has, without exception, declared void every attempt at pledge of personalty, no matter what form the parties used, which either expressly or impliedly reserved to the debtor the right to consume the property by use or exhaust it by sale. The Master says:

> "This use of such instruments of title or lien meets at the threshold, the law of Tennessee, which is firmly established, that there can be no title or lien on personal property that may be consumed by use or exhausted by sale." (Vol. 2, p. 386.)

In the case at bar the debtor and those interested in it, many of whom were stockholders and directors of the banks, desired to keep it going after it had lost all of its operating capital, and they did keep it going until they almost entirely wore out the bondholders' security. (Property se-

curing $1,216,000.00 worth of bonds only brought $453,-300.00) (Vol. 2, p. 410). To do this the field warehousing system was devised, with the intent and purpose on the part of the banks and the bankrupt of keeping its every asset covered by secret liens, so that the bankrupt could operate with every outward show of a solvent going concern, obtain credit, and then when the inevitable crash should come, the banks would assert claims to every asset to the exclusion of all other creditors.

With respect to such an arrangement, the Supreme Court of Tennessee has said:

> "Creditors, or those bound as security for other persons, cannot be permitted to secure their honest debts on the debtor's property, and at the same time to cover his remaining all from every other creditor, with the intent to let the debtor use and exhaust his means of payment, reserving the object secretly intended to be applied to the mortgagee's debt. Hence it is that the face of the courts has always been so strongly set against these sweeping deeds." (Morgan Bros. v. Dayton Coal & Iron Co., 134 Tenn. 228, at p. 267.)

And:

> "It seems, therefore, to be entirely settled in Tennessee, as indeed it is in many states, that a mortgage given upon property necessarily consumable in its use, where the possession and right of user is reserved in the grantor, is null and void; also that a mortgage upon a stock of goods, where the right of possession and user, in the usual course of business is retained in the mortgagor, is null and void." (134 Tenn. 228, at pps. 271-272.)

RECEIPTS VOIDED BY COLLATERAL AGREEMENT.

The warehouse receipts were issued from time to time for one hundred tons or other convenient quantities of cottonseed, and each receipt specifically designated the location of the seed or products described therein at a particular mill as required by statute (Vol. 2, p. 354).

> "The warehouse company in October or November made an agreement with the National that it could crush seed at any one mill regardless of outstanding warehouse receipts at that mill, provided that there was sufficient seed at other mills in excess of all outstanding warehouse receipts." (Vol. 2, p. 385.)
>
> "* * * It was his (the Trustee's) further insistence that an audit (Exhs. 207-215) disclosed that the warehouse company did not attempt to make quantities on hand correspond to outstanding warehouse receipts and that the head warehouseman was forced to admit it, and I so find." (Vol. 2, p. 346.)

And it was even proved and reported by the Master that:

> "At times warehouse receipts for cottonseed at a specified mill were issued when there was no excess seed at that mill." (Vol. 2, p. 356.)

The importance and tremendous significance of this is that the Negotiable Warehouse Receipts Act required that the receipts contain a description of the merchandise and show its location.* The agreements and methods pursued in this case utterly falsified the face of the receipts. The receipts would call for one hundred tons of cottonseed in Morrilton, Arkansas. The seed would not be there. The

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*Williams Tennessee Code, Vol. 5, provides:

"7533 3608a2. **Form of receipts and essential terms.**—Warehouse receipts need not be in any particular form, but every such receipt **must** embody within its written or printed terms:

(a) **Location.**—The location of the warehouse where the goods are stored."

banks claimed that the arrangement would permit that receipt to fasten a lien upon seed in Cairo, Illinois; Dallas, Texas, or Memphis, Tennessee, if there happened to be any excess seed at any one or more of those mills.

The audits (Exhs. 207-215) show that time and time again receipts would be outstanding calling for cottonseed at a specified mill, aggregating hundreds and sometimes thousands of tons in excess of the actual seed at that mill, and those exhibits show that there was hardly a day when there was not a large shortage at some mill.

The learned United States Circuit Court of Appeals disposed of this question as follows:

> "* * * While the Uniform Negotiable Receipts Act provides that the receipts shall state the location of the warehouse in which the goods are stored (Williams Tenn. Code 7533a), such alteration as is here complained of is permitted (Tenn. Code 1932, Sec. 7544), when, as found by the Master, the holder has agreed to accept delivery at other points."
>
> 118 F. (2d), p. 213.

The statute referred to reads as follows:

> "7544. *Altered receipts; liability and rights under them.*—The alteration of a receipt shall not excluse the warehouseman who issued it from any liability if such alteration was (a) immaterial, (b) authorized, or (c) made without fraudulent intent. If the alteration was authorized, the warehouseman shall be liable according to the terms of the receipt as altered. If the alteration was unauthorized, but made without fraudulent intent, the warehouseman shall be liable according to the terms of the receipt as they were before alteration.
>
> Material and fraudulent alteration of a receipt shall not excuse the warehouseman who issued it from lia-

> bility to deliver according to the terms of the receipt as originally issued, the goods for which it was issued, but shall excuse him from any other liability to the person who made the alteration and to any person who took with notice of the alteration. Any purchaser of the receipt for value without notice of the alteration shall acquire the same rights against the warehouseman which such purchaser would have acquired if the receipt had not been altered at the time of the purchase. (Williams Tenn. Code, 1932, Sec. 7544.)

It is not necessary to argue that the section relied on in the opinion does not purport to vest a lien in any way, nor does it purport to deal with the rights of receipt holders as against a bankrupt's creditors or a trustee in bankruptcy, but deals only with the liability of the warehouseman. Furthermore, it appears from the wording of the statute that it is dealing only with alterations appearing on the face of the receipt, and not with secret oral agreements existing between warehousemen and receipt holders.

While this case is of tremendous importance to creditors of this bankrupt, because as the decision now stands they will receive only a nominal dividend, and at least two of the banks will receive approximately one hundred per cent of their claims, the decision is far more important and far-reaching in the effect it will have in the numberless cases to be hereafter disposed of in the National Bankruptcy Courts.

As stated in the opinion of the Circuit Court of Appeals, Sixth Circuit, petitioner has conceded that a valid system of field warehousing may be conducted. It is equally true that the system, as a business method, is widespread and perhaps of great economic importance. It is believed, however, that with full and fair compliance with the requisites

to a valid pledge of property left upon the premises of the pledgor, such a system or scheme is necessarily near the field of secret lien. It logically follows that any relaxation or disregard of the requisites to a valid lien on property left upon the premises of the pledgor at once leads to the deception and legal fraud of creditors that the rule against secret liens was adopted to avoid. If fair regard for the rights of creditors is to be preserved in bankruptcy, there should be no relaxation of such requisites.

The United States Circuit Court of Appeals cited Union Trust Co. v. Wilson, 198 U. S. 530, 25 S. Ct. 766, 49 L. Ed. 1154, in support of its holdings. It is respectfully submitted that the facts in this case do not bring it within the holding in that case. It is our respectful insistence that the field warehouseman was attempting to do exactly what the field warehouseman attempted to do in the Hand case, namely, get the Court to extend the rule announced in the Union Trust Company case to a point where the system could be operated with the debtor remaining in full possession and control of the so-called pledged property. In the Union Trust Company case Mr. Justice Holmes took particular pains to point out and emphasize that the warehousemen took and maintained the actual and exclusive possession of the pledged property. In the Hand case the Court declined to extend the rule to a system which really amounted to a contractual right to possession, but which in practical operation left the debtor in possession and use.

Paraphrasing the last paragraph of the foregoing quotation from the opinion of this Honorable Court in the Hand case, we have:

> "The actual transaction in the case at bar differ radically from the facts as stated in Union Trust

Company v. Wilson, supra. The Court there held that there was sufficient proof to show a change of possession, and that the transaction was valid within the law of the State of Illinois. Assuming the law of Tennessee to be the same on the subject of possession by the pledgee of the property pledged, the facts in this case are so different from the Wilson case as to prevent that case from forming a foundation for holding there was a sufficient change of possession here to make the pledge a valid one."

Respectfully submitted,

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